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California State Assembly

BILL LEONARD

ASSEMBLYMEMBER, SIXTY-THIRD DISTRICT

COMMITTEES:
RULES (VICE CHAIR)
BUDGET
BUDGET SUBCOMMITTEE ON EDUCATION FINANCE
SELECT COMMITTEES:
TRANSPORTATION CONGESTION RELIEF
SCHOOL FACILITIES FINANCE
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NEWS RELEASE
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JULY 22, 2002
FOR IMMEDIATE RELEASE

LAO SAYS 1991 BUDGET CRISIS TAX INCREASES FELL SHORT OF EXPECTATIONS

SACRAMENTO-- Assemblyman Bill Leonard (R- Rancho Cucamonga) announced today that Legislative Analyst Elizabeth Hill has calculated that the amount of money raised in 1992, 1993 and 1994 because of tax increases imposed during the budget crisis of 1991-92 was not as much as the original revenue estimates predicted, and these predictions were "substantially overstated."

"California's recent history shows us that revenue projections from new taxes are not reliable. We cannot count on this money coming into the state coffers," said Assemblyman Leonard. "That makes the Governor's proposal an Enron-style budget that will lead to a dramatic loss of confidence in our government and ultimately harm the state's economy. We owe the people of California a more honest effort to balance our books."

The Analyst's office looked at the three main components of the 1991 tax increase: the increase in the Sales and Use Tax (SUT) rate; the establishment of high-income tax brackets; and the suspension of Net Operating Loss (NOL) carryovers. The LAO found that the total difference in 1991-92 between the original revenue estimates and the actual revenues for the three major provisions was about $800 million, approximately 20 percent lower than forecast. Shortfalls also occurred in 1992-93 and 1993-94 as well, totaling $475 million and $560 million, respectively.

# # #

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COMPTON UNIFIED SCHOOL DISTRICT

July 22, 2002

TO: ALL MEMBERS

FROM: ASSEMBLYMAN BILL LEONARD

RE: REVENUE ESTIMATES FROM LAST BUDGET CRISIS

Dear Colleague:

Legislative Analyst Elizabeth Hill has calculated that the amount of money raised in 1992, 1993 and 1994 because of tax increases imposed during the budget crisis of 1991-92 was not as much as the original revenue estimates predicted, and these predictions were "substantially overstated."

The Analyst's office looked at the three main components of the 1991 tax increase: the increase in the Sales and Use Tax (SUT) rate; the establishment of high-income tax brackets; and the suspension of Net Operating Loss (NOL) carryovers. The LAO found that the total difference in 1991-92 between the original revenue estimates and the actual revenues for the three major provisions was about $800 million, approximately 20 percent lower than forecast. Shortfalls also occurred in 1992-93 and 1993-94 as well, totaling $475 million and $560 million, respectively.

Thank you for your attention.

July 18, 2002

Hon. Bill Leonard
Assembly Member, 63rd District
Room 4117, State Capitol
Sacramento, California 95814

Dear Assembly ~~Member~~ Bill Leonard:

You requested that we provide you with information relating to tax increases that were adopted in 1991 to deal with the state's budget problems during that period. In particular, you asked for information comparing the original revenue estimates associated with these tax measures to the actual amount of revenues raised in 1992, 1993, and 1994, following their adoption. This information is presented below.

1991-92 General Fund Revenue Increases

The revenue increases that were adopted by the Legislature as part of the 1991-92 budget included a wide range of activities. In broad categorical terms, these measures consisted of the following: tax rate and base changes, one-time revenue accelerations, treatment of accrued revenues, and the delay or suspension of certain tax expenditures.

These various measures were adopted with the expectation that they would generate additional revenue of approximately $6.6 billion. Of this amount:

- Approximately $1.5 billion was due to an accounting change that allowed the accrual of certain revenues on a one-time basis.
- The remaining $5.1 billion was comprised of increases in various taxes.

Tax Increases

Of the $5.1 billion in increased taxes, approximately one-quarter stemmed from relatively minor changes in existing tax programs, including: (1) increases in alcoholic beverage tax rates, (2) expansion of the sales and use tax (SUT) base, (3) federal conformity measures, (4) delay in the effective date of a health care credit, (5) acceleration of taxes on supplemental wages, and (6) tax changes with respect to estates and trusts. The remaining three-quarters of the $5.1 billion tax increase consisted of significant changes to the SUT, the personal income tax (PIT), and the corporation tax. These tax changes were in turn, comprised of the following:

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- *Increase in SUT Tax Rate.* Under the 1991-92 budget agreement, the General Fund SUT rate was increased to 5.5 percent from 4.75 percent beginning July 15, 1991. (The SUT rate was later reduced to 5 percent beginning July 1, 1993.)
- *Establishment of High-Income Tax Brackets.* The budget agreement also put in place 10 percent and 11 percent PIT brackets for high-income taxpayers. These high-income brackets were in effect during tax years 1991 through 1995.
- *Suspension of Net Operating Loss (NOL) Carryovers.* Under the budget agreement, the ability of businesses to deduct from current-year income NOLs incurred in prior years was suspended for tax years 1991 and 1992. In conjunction with this, the carryover period was extended for an additional two years to prevent NOLs from expiring (as provided in statute) due to the two-year suspension.

Given the large proportion of the estimated revenue increases associated with the three tax measures detailed above, we have limited our comparison of revenue estimates to these three principal tax changes.

Comparison of Estimated and Actual Revenues

As shown in Figure 1, the original revenue estimates for the three major tax policy changes adopted in conjunction with the 1991-92 budget were substantially overstated compared to revenues actually realized. (In the case of the NOL suspension and the PIT brackets, actual revenues are estimated from best available data.) For 1991-92, the SUT rate increase was originally estimated to generate about $2.2 billion in additional revenues, but generated only $1.8 billion. The revenue shortfalls in 1991-92 for the additional PIT brackets and the suspension of NOL carryovers were $152 million and $303 million, respectively. Thus, the total difference in 1991-92 between the original revenue estimates and the actual revenues for the three major provisions for 1991-92 was about $800 million, representing an error of approximately 20 percent. Somewhat lower—but nevertheless substantial—shortfalls occurred in 1992-93 and 1993-94 as well, totaling $475 million and $560 million, respectively.

Figure 1

Major Tax Changes Enacted in 1991
Estimated and Actual Revenues

(In Millions)

Tax Provision	1991-92	1992-93	1993-94
SUT Rate Increase			
Estimate[a]	$2,153	$2,244	$2,120
Actual[a]	1,801	1,931	1,961
Differences	-$352	-$313	-$159
High-Income PIT Brackets			
Estimate[b]	$1,212	$956	$1,042
Actual[c]	1,060	849	750
Differences	-$152	-$107	-$292
Two-Year NOL Suspension			
Estimate[b]	$560	$457	-$209
Actual[d]	257	401	-317
Differences	-$303	-$56	-$108
Totals	**-$807**	**-$476**	**-$559**

a Based on Governor's Budgets. Assumes three-quarter cent rate increase throughout the period.
b Based on LAO estimates, September 1991.
c Based on LAO estimates, February 1992 and September 1993.
d Based on LAO estimates, February 1992 and February 1993.

Causes of Revenue Estimating Errors

There are a variety of reasons for the discrepancies between estimated and actual revenues resulting from the major measures that were adopted in 1991. *The most important contributor to the revenue shortfalls that occurred was the substantial and prolonged decline in the California economy during this period.* In particular, the anticipated revenues from the NOL suspension, the additional PIT brackets for high-income taxpayers, and the higher SUT tax rate were highly sensitive to the substantial declines that occurred in corporate profits, personal income, and taxable sales.

Other contributing factors to the revenue shortfalls include:

- Difficulties in accurately anticipating taxpayer behavioral responses to the tax changes.
- Data limitations generally inherent to revenue forecasting and estimating the effects of tax changes.

- Shortcomings associated with tax and revenue forecasting methodologies.

Examples of the latter include problems in (1) accurately forecasting capital gains and stock options and distributing them amongst income levels, and (2) appropriately linking the utilization of stocks of NOLs to the profit performance of individual firms.

If you have questions regarding the above information or have additional questions, please feel free to contact Mark Ibele of my staff at 319-8308.

Sincerely,

Elizabeth G. Hill
Legislative Analyst